No. 15981

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEE.

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BRIEF FOR THE APPELLEE.

Opinion Below.

The opinion below is not reported.

Jurisdiction.

This is an action for the recovery of income taxes paid, by withholding, for the year 1952. [R. 21.] A timely claim for refund was denied on May 24, 1954. [R. 21.] On October 11, 1954 [R. 12], and within the time prescribed by Section 6532 of the Internal Revenue Code of 1954, this action was instituted in the District Court [R. 3-12], pursuant to 28 U. S. C., Section 1346.

The judgment of the District Court was entered on February 12, 1958 [R. 58], and within less than sixty days thereafter, namely, on February 27, 1958, a notice of appeal to this Court was filed [R. 59], pursuant to 28 U. S. C., Section 1291.

As hereinafter indicated, at the close of the argument, *infra,* there may be a question as to jurisdiction with regard to the taxpayer's claim for affirmative relief for the reason that the action in the District Court was instituted before the entire tax for the taxable year had been paid.

Question Presented.

Whether the retirement pay received by the taxpayer from the United States Navy during the year 1952 was received as a pension, annuity or similar allowance for personal injury or sickness resulting from active service in the United States Navy within the meaning of Section 22(b)(5) of the Internal Revenue Code of 1939.

Statute Involved.

Internal Revenue Code of 1939:

> SEC. 22 [as amended by Section 113 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. GROSS INCOME.
>
> * * * * * * * *
>
> (b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> * * * * * * * *
>
> (5) *Compensation for injuries or sickness.*—* * * amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;
>
> * * * * * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Statement.

The following is submitted as a summary of the undisputed facts as reflected in the stipulation of facts [R. 21-25]:

The taxpayer was an enlisted man in the United States Navy from May 6, 1918, to June 26, 1939, at which time

he was released from active duty and transferred to what was known as the "Fleet Reserve," the transfer being based on length of service. In September of the same year the taxpayer was recalled to active duty, given a physical examination, and found to be physically fit for all duty. The taxpayer served on active duty from September 1939 to February 1943, and was stationed on shore in the San Diego, California, area. On February 18, 1943, he was released from active duty as the result of a physical examination which disclosed that he had arteriosclerosis, defective vision (which was corrected by glasses) and varicose veins. [R. 22.]

The record accompanying the physical examination stated that the taxpayer was not fit to perform active duty or physically qualified for any duty and that he should be placed on the retired list. In accordance with this recommendation the taxpayer was released from active duty and placed on the retired list on March 1, 1943. [R. 22-23.]

With regard to his retirement pay, after the adoption of the Career Compensation Act of 1949, c. 681, 63 Stat. 802 (37 U. S. C. 1952 ed., Sec. 231), the taxpayer was advised that he had a choice of electing options for computing retirement pay under the provisions of the Act.* The taxpayer was also informed that he had been assigned a percentage disability of zero (0) for purposes of computing such pay under the above-mentioned options. The taxpayer first elected option "B" which computed compensation based on a method established by the Career Compensation Act. Subsequently, the taxpayer changed his election to option "C" which computed compensation based on laws in effect prior to the adoption of the 1949 Career Compensation Act. [R. 23.]

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*Prior to the 1949 Act, the taxpayer's retirement pay was computed under laws then in effect. Such pay was computed on the basis of length of service only. [R. 23-24.]

In February of 1946 the taxpayer filed an application with the Board for Correction of Naval Records, Department of the Navy, for the purpose of having the percentage of disability assigned to him by the Bureau of Naval Personnel corrected. The Board for the Correction of Naval Records denied the taxpayer's application on the basis that the disability rating of zero percent already assigned by the Physical Review Council was correct and proper, and that the taxpayer's medical records did not indicate that he was suffering from a disability ratable under the schedule for rating disabilities in current use by the Veterans Administration at the time of his retirement in March of 1943. [R. 24.]

The taxpayer's retirement pay is computed and based upon over twenty-four years of active service in the United States Navy, and no portion of his pay is computed on the basis of a disability factor. [R. 24.]

In 1954 the taxpayer filed a claim with the Commissioner of Internal Revenue for refund of $22.10 withheld as income tax for the year 1952. The claim was based upon the contention that the taxpayer's retirement pay received from the Navy was exempt from tax, because it was pay received for physical disability resulting from active service. The claim for refund was denied, and it was also established that if the retirement pay is taxable income the taxpayer owes an additional tax of $256.90 for the year 1952. [R. 21.]

Upon the denial of the taxpayer's claim he filed suit in the District Court for the refund of the income tax paid for the year 1952 in the amount of $22.10. The Government filed a counterclaim against the taxpayer for the additional tax liability for the year 1952 of $256.90. The District Court denied the taxpayer's claim and granted the Government's counterclaim, from which judgment the taxpayer has appealed to this Court.

Summary of Argument.

The present case is distinguishable on its facts from both the *Prince* and *McNair* decisions. In each of those cases the Navy (or the Army) had determined that the member of the service could have been retired for disability and have been paid the same amounts as he received under his retirement for length of service. Here, the Navy has specifically determined that the taxpayer was not entitled to retirement for disability. In 1950 the taxpayer was given a physical disability rating of zero under a schedule of rating disabilities in use at the time of the taxpayer's retirement, and in 1956 this rating was reexamined and approved when the taxpayer applied for change of such rating.

It is also clear that if the taxpayer had a disability which merited rating by the Navy, the taxpayer might well receive an entirely different amount from that which he received under his retirement for length of service, contrary to the situation in the *Prince* and *McNair* cases. These facts plainly indicate that the taxpayer was not refused retirement pay on the ground that such pay would be no higher than pay computed on length of service but was refused retirement pay on the ground that he was not entitled to disability pay at all.

The courts have laid down the principle that one claiming the benefits of an exemption from taxation granted by Congress to persons of a particular status must bring himself clearly within the claimed status. This rule is particularly pertinent in the present case, for the taxpayer has presented no specific evidence to support his allegation that his retirement pay was due to personal injuries or sickness. Accordingly, the taxpayer has failed to prove that he is entitled to an exemption under Section 22(b)(5).

ARGUMENT.

The Taxpayer's Retirement Pay Was Not Received for Personal Injuries or Sickness Resulting From Active Service in the United States Navy.

The issue in this case is whether the taxpayer's retirement pay is received for personal injuries or sickness resulting from active service in the United States Navy. If the taxpayer's retirement pay was not so received, the parties have stipulated that it is taxable income. [R. 24-25.]

Section 22(b)(5) of the Internal Revenue Code of 1939, *supra,* is the provision under which the taxpayer claims that his retirement pay is not taxable. It provides that "amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country" shall be exempt from tax. The parties have stipulated [R. 24] that the taxpayer's retirement pay is computed only on the basis of length of service. This fact itself would seem to establish, under a strict interpretation of the statute, that the retirement pay is not received as compensation for personal injuries or sickness. However, the Court of Claims, *Prince v. United States,* 119 F. Supp. 421, and the United States Court of Appeals for the Fourth Circuit, *McNair v. Commissioner,* 250 F. 2d 147, have recently granted exemptions under Section 22(b)(5) in situations where the retirement pay was technically based upon length of service.

In the *Prince* case, the taxpayer, an Army Colonel, permitted himself to be retired for 30 years service in 1943, although due to his physical condition he was eligible for retirement, and for an allowance of retirement pay, based upon disability. Upon retirement, he was immediately

recalled to active duty but a few months later an Army Board found him incapacitated for active service and returned him to the lists of those retired for age. The court found that, although the pay he received would be the same whether he was retired for age or disability, he refused the more advantageous, taxwise, form of retirement through patriotism or ignorance of the law and held, one judge dissenting, that, under such circumstances, equity required a decision that his retirement pay was exempt from tax.

The *McNair* decision is very similar to *Prince*. The taxpayer, a Navy officer, was retired for age, recalled, and later found physically incapacitated and eligible for retirement for disability, but was refused disability pay on the ground that such pay would not exceed his retirement pay based only on length of service. The court held that, since the taxpayer was obviously eligible for disability pay, a fair construction of the statute would grant the tax exemption.

The instant case is distinguishable on its facts from both *Prince* and *McNair*. In each of those cases the Navy (or the Army) had determined that a member of the service could have been retired for disability and would have received the same amount as he received under his retirement for length of service. The court in each instance based its holding on the fact that the retiree was deprived of his established right to retirement on the basis of physical disability. In the present case, the Navy has specifically determined that the taxpayer is not entitled to a retirement for disability. In 1950, when the taxpayer was given an opportunity to elect to have his retirement pay computed under various options established by the Career Compensation Act of 1949, he was informed that his percentage of disability rating was zero. [R. 34.] In 1956, the tax-

payer applied for a change of this rating but was told that the Bureau of Medicine and Surgery, after a review of his medical record, concluded that the rating was correct. [R. 29-32.]

This rating of zero precludes any possibility that the taxpayer's pay is based upon physical disability or that the taxpayer is, or was ever, entitled to have retirement pay computed on the basis of physical disability. Under the Career Compensation Act of 1949, Section 402(a) (37 U. S. C. 1952 ed., Sec. 272), no disability retirement pay shall be received unless "such disability is 30 per centum or more in accordance with the standard schedule of rating disabilities in current use by the Veterans Administration." As mentioned, the taxpayer's rating under such schedule for rating disabilities is zero.

It also should be made clear that under the Career Compensation Act of 1949 the taxpayer's disability, if he had one which could be rated, might well result in his receiving an entirely different amount from that which he received under his retirement for length of service, contrary to the situation in the *Prince* and *McNair* cases. The options, outlined in the letter from the Navy in 1950 [R. 36-38], for computing retirement pay demonstrates this fact. Under Methods B or C, computed on the basis of length of service only, the taxpayer received approximately 60% of his base pay. Under Method A, depending upon the percentage of disability, the taxpayer could have received up to 75% of his basic pay, had he been eligible to compute his retirement allowance by such method. These facts show that the taxpayer was not refused retirement pay on the ground that such pay would be no higher than pay computed on the basis of length of service, but that he was not entitled to disability pay at all.

The fact that the taxpayer's retirement pay is computed under laws existing prior to the passage of the Career Compensation Act of 1949 is not important. The taxpayer's rating under the Act of a percentage disability of zero clearly demonstrates, regardless of the particular statute applicable to the computation, that the Navy has determined that there exists no disability as a basis for fixing an amount of relief for disability. The taxpayer has not shown, and has not attempted to show, that his degree of physical disability was the subject of a determination prior to 1949 for purposes of retirement pay. Therefore, in the absence of such a showing it must be assumed that the rating in 1950, under a schedule for rating disabilities in use by the Veterans Administration at the time of the taxpayer's retirement in 1943 [R. 32], is representative of the taxpayer's actual condition at the time of his retirement. Even the *Prince* decision (p. 424) noted that where there has been no determination as to the extent of disability as a basis for fixing an amount of relief for disability, no exemption is warranted. See also *Simms v. Commissioner,* 196 F. 2d 238 (C. A. D. C.). In the same vein, where the determination has been that there is no disability sufficient to warrant a computation of retirement pay based on disability, no exemption is warranted.

The *McNair* case also supports this proposition by noting that other decisions in this field, *Scarce v. Commissioner,* 17 T. C. 830; *Pangburn v. Commissioner,* 13 T. C. 169; *Simms v. Commissioner, supra,* which have refused to grant Section 22(b)(5) exemptions, may be distinguished on the facts. The obvious distinction is that in *McNair* the Navy recognized that the taxpayer could have been retired for a disability which would have resulted in allowance of disability pay, whereas in other cases, as in the present case, there was no evidence in the record that

disabilities had been recognized for purposes of the allowance of disability pay.

The courts have reiterated again and again that one claiming the benefits of an Act of Congress passed for a particular class, or one claiming an exemption from taxation granted by Congress to persons of a particular status, must bring himself clearly within the claimed class or status, and that Acts of this character are thereby strictly construed. *Commissioner v. Connelly,* 338 U. S. 258; *Mitchell v. Cohen,* 333 U. S. 411; *United States v. Popham,* 198 F. 2d 660 (C. A. 8th). This rule is particularly pertinent in this type of case. Here, other than a general allegation, the taxpayer has presented no specific evidence which would support his contention that his retirement pay was due to personal injuries or sickness resulting from active service. Accordingly, the taxpayer has failed to show that he is entitled to the exemption provided by Section 22(b)(5).

Before closing, we feel it our duty to call to the Court's attention a matter which affects the jurisdiction in this case. The record shows that this action was instituted before the taxpayer had paid the entire amount of income tax for the taxable year 1952. [R. 21, 58.] By a recent decision of the Supreme Court, it has now become settled that the courts have no jurisdiction over a suit for refund prior to the payment of the entire tax for a given year. *Flora v. United States,* 357 U. S. 63. In the present case, although the Government answered the complaint and filed a counterclaim against the taxpayer for the balance of the unpaid tax, these pleadings cannot waive or cure the jurisdictional defect because it is well settled that parties by their action cannot confer upon the courts jurisdiction over the subject matter of the action where such jurisdiction does not exist.

While the Court lacks jurisdiction over the taxpayer's claim for affirmative relief, there is no corresponding jurisdictional failure with regard to the Government's counterclaim. It has been held that if a plaintiff's action is dismissed, the dismissal does not preclude a trial and determination of the issue presented by the counterclaim, where the court's jurisdiction over the counterclaim has an independent basis. *Isenberg v. Biddle,* 125 F. 2d 741 (C. A. D. C.); *Switzer Bros. v. Chicago Cardboard Co.,* 252 F. 2d 407 (C. A. 7th). See also, *Lion Mfg. Corporation v. Chicago Flexible Shaft Co.,* 106 F. 2d 930 (C. A. 7th). Here, the Court's jurisdiction over the counterclaim rests upon Section 7401 of the Internal Revenue Code of 1954, whereas, jurisdiction over the taxpayer's suit must necessarily depend upon the provisions of Section 1346(a)(1) of Title 28, U. S. C.

Accordingly, although this Court may wish to remand the taxpayer's claim for affirmative relief to the District Court with instructions to dismiss for lack of jurisdiction, the Court clearly has jurisdiction over the Government's counterclaim, and the judgment upon the counterclaim should be sustained on its merits.

Conclusion.

For the foregoing reasons, the judgment of the District Court should be affirmed.

Respectfully submitted,

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